

As of December 31, 2011, our outstanding borrowings under the Term Facility were \$589.7 million and accrued interest under the Facilities was \$4.5 million. As of December 31, 2011, the Company's available borrowings under the Revolving Facility were \$100 million.

Discussion of Cash Flows

2011 compared to 2010

Cash flows from operations

Net cash provided by operating activities for the year ended December 31, 2011 was \$226.4 million, as compared to \$144.8 million for the year ended December 31, 2010. This \$81.6 million increase in net cash provided by operating activities was the result of an increase in net income of \$54.6 million, an increase in non-cash adjustments of \$29.4 million, and a decrease in net changes in operating assets and liabilities of \$2.4 million.

Net income increased \$54.6 million primarily due to a change of \$55.1 million in the income tax benefit from discontinued operations. In the first quarter of 2011, we recorded a tax benefit of \$42.7 million related to a worthless stock deduction for the common stock of Neustar NGM Services, Inc.

Non-cash adjustments increased \$29.4 million due to an increase of \$19.5 million in deferred income taxes, an increase of \$9.8 million in stock-based compensation, an increase of \$6.7 million in depreciation and amortization expense, an increase of \$3.0 million in amortization of bond premiums, and a \$1.9 million loss-on-sale attributable to the sale of certain assets and liabilities of our Converged Messaging Services business in the first quarter of 2011. These increases in non-cash adjustments were partially offset by a decrease of \$8.5 million attributed to an impairment of long-lived assets of our Converged Messaging Services business recorded in 2010, and a decrease of \$2.9 million in excess tax benefits from stock option exercises.

Net changes in operating assets and liabilities decreased \$2.4 million primarily due to an increase of \$18.8 million in income taxes receivable, primarily the result of the tax benefit we recorded in the first quarter of 2011 in connection with a deduction for the loss on worthless stock, a decrease of \$10.0 million in other liabilities, and an increase of \$7.7 million in prepaid expenses and other current assets. In addition, deferred costs increased \$3.7 million and notes receivable increased \$3.4 million. These decreases in net changes in operating assets and liabilities were partially offset by a net change of \$25.2 million attributable to net increases in accounts payable and accrued expenses during 2011 as compared to decreases in 2010, and a net change of \$20.2 million attributable to net decreases in accounts and unbilled receivables during 2011 as compared to increases in 2010.

Cash flows from investing

Net cash used in investing activities for the year ended December 31, 2011 was \$706.4 million, as compared to \$72.8 million for the year ended December 31, 2010. This \$633.6 million increase in net cash used in investing activities was primarily due to an increase of \$673.9 million in cash used for acquisitions, an increase of \$30.5 million in investment purchases, and an increase \$7.7 million in cash used for purchases of property and equipment. These increases in net cash used in investing activities were partially offset by the increase of \$78.4 million in cash received from the sales of investments.

Cash flows from financing

Net cash provided by financing activities was \$270.9 million for the year ended December 31, 2011, as compared to net cash used in financing activities of \$45.0 million for the year ended December 31, 2010. This \$315.9 million increase in net cash provided by financing activities was primarily the result of net proceeds of \$591.0 million from our senior secured term loan facility, and an increase of \$31.5 million in proceeds from the exercise of stock options and a reduction of \$5.0 million in cash used in principal repayments on capital lease

obligations. These increases in cash provided by financing activities were partially offset by an increase of \$283.9 million in cash used to repurchase shares of our Class A common stock under our share repurchase programs, an increase of \$20.4 million in debt issuance costs, and a net increase of \$8.8 million in restricted cash primarily used to collateralize our outstanding letters of credit.

2010 compared to 2009

Cash flows from operations

Net cash provided by operating activities for the year ended December 31, 2010 was \$144.8 million, as compared to \$175.3 million for the year ended December 31, 2009. This \$30.5 million decrease in net cash provided by operating activities was principally the result of a decrease in accounts payable and accrued expenses of \$23.0 million and an increase in accounts receivable of \$21.1 million. These decreases in net cash provided by operating activities were partially offset by a decrease in deferred revenue of \$10.9 million.

Cash flows from investing

Net cash used investing activities for the year ended December 31, 2010 was \$72.8 million, as compared to \$10.6 million for the year ended December 31, 2009. This \$62.2 million increase in net cash used in investing activities was principally due to our use of cash for the purchases of the pre-refunded municipal bonds of \$50.8 million in 2010, an increase of \$21.3 million in cash paid for acquisitions, and an increase of \$12.6 million in purchases of property and equipment. These uses of cash were partially offset by an increase in cash provided by sales of short-term investments of \$22.5 million attributable to our ARS and ARS Rights.

Cash flows from financing

Net cash used in financing activities was \$45.0 million for the year ended December 31, 2010, as compared to \$11.1 million for the year ended December 31, 2009. The \$33.9 million increase in net cash used in financing activities was primarily driven by \$40.4 million in repurchases of our Class A common stock under a share repurchase program announced in July 2010, and this use was partially offset by an increase of \$6.1 million in proceeds from the exercise of stock options.

Contractual Obligations

Our principal commitments consist of obligations under our 2011 Credit Facilities, leases for office space, computer equipment and furniture and fixtures, and deferred tax liabilities. The following table summarizes our long-term contractual obligations as of December 31, 2011.

	Payments Due by Period				
	Total	Less Than 1 Year	2-3 Years	4-5 Years	More Than 5 Years
			(in thousands)		
Capital lease obligations	\$ 5,332	\$ 3,313	\$ 2,019	\$ —	\$ —
Operating lease obligations	86,050	11,954	21,542	18,219	34,335
Term Facility (1)	799,671	36,309	71,539	70,402	621,421
Deferred tax liabilities	121,237	28,348	48,610	33,912	10,367
Total	<u>\$1,012,290</u>	<u>\$79,924</u>	<u>\$143,710</u>	<u>\$122,533</u>	<u>\$666,123</u>

- (1) Includes interest expense calculated using the interest rate at December 31, 2011 of 5% per year. Under our Term Facility and Revolving Facility, we may be required to make mandatory prepayments with the net cash proceeds of certain debt issuances, equity issuances, insurance receipts, dispositions and excess cash flows. The amounts presented in the tables above do not reflect the acceleration of mandatory prepayments that we may be required to pay.

Some of our commercial commitments are secured by standby letters of credit. The following is a summary of our commercial commitments secured by standby letters of credit by commitment date as of December 31, 2011:

	<u>Total</u>	<u>Less Than 1 Year</u>	<u>1-3 Years</u>	<u>4-5 Years</u>	<u>More Than 5 Years</u>
	(in thousands)				
Standby letters of credit	<u>\$8,760</u>	<u>\$8,760</u>	<u>\$—</u>	<u>\$—</u>	<u>\$—</u>

The amounts presented in the tables above may not necessarily reflect our actual future cash funding requirements because the actual timing of the future payments made may vary from the stated contractual obligation. In addition, due to the uncertainty with respect to the timing of future cash flows associated with our unrecognized tax benefits at December 31, 2011, we are unable to make reasonably reliable estimates of the period of cash settlement with the respective taxing authority. Therefore, we have not included \$1.6 million of unrecognized tax benefits and interest thereon, in the contractual obligations table above. See Note 13 to the consolidated financial statements in Item 8 of Part II of this report for a discussion on income taxes.

Effect of Inflation

Inflation generally affects us by increasing our cost of labor and equipment. We do not believe that inflation had any material effect on our results of operations during the years ended December 31, 2009, 2010 and 2011.

Recent Accounting Pronouncements

See Note 2 to our Consolidated Financial Statements in Item 8 of Part II of this report for a discussion of the effects of recent accounting pronouncements.

Off-Balance Sheet Arrangements

We had no off-balance sheet arrangements as of December 31, 2010 and 2011.

ITEM 7A. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

We are exposed to a variety of market risks, including changes in interest rates affecting the return on our Term Facility, investments, and foreign currency fluctuations.

Borrowings outstanding under our Term Facility bear interest, at our option, either: (i) at the base rate, which is defined as the highest of (a) the federal funds rate plus 0.50%, (b) the interest rate published by the Wall Street Journal as the "U.S. Prime Rate" and (c) the adjusted LIBOR rate for a one-month interest period beginning on such day plus 1.00%; provided that the base rate for loans under the Term Facility is deemed to be not less than 2.25% per annum or (ii) at the LIBOR rate plus, in each case, an applicable margin. The applicable margin is (i) in respect of the Term Facility, 2.75% per annum for borrowings based on the base rate and 3.75% per annum for borrowings based on the LIBOR rate, and (ii) in respect of the Revolving Facility, 2.50% per annum for borrowings based on the base rate and 3.50% per annum borrowings based on the LIBOR rate. As of December 31, 2011, the LIBOR rate on our Term Facility was below the applicable margin, or floor, and a hypothetical increase or decrease of 10% in the LIBOR rate would not impact our interest rate.

Exposure to market rate risk for changes in interest rates affects the value of our investment portfolio. We have not used derivative financial instruments to hedge against such risk in our investment portfolio. We invest in securities of highly-rated issuers and follow investment policies limiting, among other things, the amount of credit exposure to any one issuer. We seek to limit default risk by purchasing only investment-grade securities. We do not actively manage the risk of interest rate fluctuations on our short-term investments; however, our

exposure to this risk is mitigated by the relatively short-term nature of these investments. Based on a hypothetical 10% adverse movement in interest rates, the impact on our interest income for our short-term investments for the year ended December 31, 2011 would have been insignificant.

We have accounts on our foreign subsidiaries' ledgers which are maintained in the respective subsidiary's local foreign currency and remeasured into the United States dollar. As a result, we are exposed to movements in the exchange rates of various currencies against the United States dollar and against the currencies of other countries in which we sell services. As of December 31, 2011, our assets and liabilities related to non-dollar denominated currencies were primarily related to intercompany payables and receivables. An increase or decrease of 10% in foreign exchange rate would not have a material impact on our financial position.

Because our sales and expense are primarily denominated in local currency, the impact of foreign currency fluctuations on sales and expenses has not been material, and we do not employ measures intended to manage foreign exchange rate risk.

ITEM 8. FINANCIAL STATEMENTS AND SUPPLEMENTARY DATA

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REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

Board of Directors and Stockholders
NeuStar, Inc.

We have audited the accompanying consolidated balance sheets of NeuStar, Inc. as of December 31, 2010 and 2011, and the related consolidated statements of operations, stockholders' equity, and cash flows for each of the three years in the period ended December 31, 2011. Our audits also included the financial statement schedule listed in the Index at Item 15(a)(2). These financial statements and schedule are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements and schedule based on our audits.

We conducted our audits in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the financial statements referred to above present fairly, in all material respects, the consolidated financial position of NeuStar, Inc. at December 31, 2010 and 2011, and the consolidated results of its operations and its cash flows for each of the three years in the period ended December 31, 2011, in conformity with U.S. generally accepted accounting principles. Also, in our opinion, the related financial statement schedule, when considered in relation to the basic financial statements taken as a whole, presents fairly in all material respects the information set forth therein.

We also have audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States), NeuStar, Inc.'s internal control over financial reporting as of December 31, 2011, based on criteria established in Internal Control — Integrated Framework issued by the Committee of Sponsoring Organizations of the Treadway Commission and our report dated February 29, 2012 expressed an unqualified opinion thereon.

/s/ Ernst & Young LLP

McLean, Virginia
February 29, 2012

NEUSTAR, INC.
CONSOLIDATED BALANCE SHEETS
(in thousands, except share and per share data)

	<u>December 31,</u>	
	<u>2010</u>	<u>2011</u>
ASSETS		
Current assets:		
Cash and cash equivalents	\$331,570	\$ 122,237
Restricted cash	556	10,251
Short-term investments	13,802	10,545
Accounts receivable, net of allowance for doubtful accounts of \$1,435 and \$1,942, respectively	82,250	106,274
Unbilled receivables	7,188	5,551
Notes receivable	567	2,786
Prepaid expenses and other current assets	12,797	29,714
Deferred costs	5,849	8,174
Income taxes receivable	—	37,599
Deferred tax assets	6,146	6,264
Total current assets	460,725	339,395
Long-term investments	37,009	2,506
Property and equipment, net	74,296	100,102
Goodwill	124,651	574,651
Intangible assets, net	18,974	338,768
Notes receivable, long-term	1,023	3,748
Deferred costs, long-term	1,052	701
Deferred tax assets, long-term	10,137	—
Other assets, long-term	6,007	22,767
Total assets	<u>\$733,874</u>	<u>\$1,382,638</u>

See accompanying notes.

NEUSTAR, INC.
CONSOLIDATED BALANCE SHEETS
(in thousands, except share and per share data)

	December 31,	
	2010	2011
LIABILITIES AND STOCKHOLDERS' EQUITY		
Current liabilities:		
Accounts payable	\$ 3,882	\$ 7,385
Accrued expenses	57,808	79,334
Income taxes payable	1,590	—
Deferred revenue	31,751	41,080
Note payable	—	4,856
Capital lease obligations	6,325	3,065
Accrued restructuring reserve	4,703	4,361
Other liabilities	9,445	5,317
Total current liabilities	115,504	145,398
Deferred revenue, long-term	10,578	10,363
Note payable, long-term	—	584,809
Capital lease obligations, long-term	4,076	1,918
Accrued restructuring reserve, long-term	315	—
Deferred tax liability, long-term	—	121,237
Other liabilities, long-term	7,289	16,279
Total liabilities	137,762	880,004
Commitments and contingencies	—	—
Stockholders' equity:		
Preferred stock, \$0.001 par value; 100,000,000 shares authorized; no shares issued and outstanding as of December 31, 2010 and 2011	—	—
Class A common stock, par value \$0.001; 200,000,000 shares authorized; 80,294,573 and 82,959,411 shares issued and outstanding at December 31, 2010 and 2011, respectively	80	83
Class B common stock, par value \$0.001; 100,000,000 shares authorized; 3,082 and 3,082 shares issued and outstanding at December 31, 2010 and 2011, respectively	—	—
Additional paid-in capital	364,346	436,598
Treasury stock, 6,665,228 and 16,807,932 shares at December 31, 2010 and 2011, respectively, at cost	(169,848)	(495,790)
Accumulated other comprehensive loss	(144)	(758)
Retained earnings	401,678	562,501
Total stockholders' equity	596,112	502,634
Total liabilities and stockholders' equity	<u>\$ 733,874</u>	<u>\$1,382,638</u>

See accompanying notes.

NEUSTAR, INC.
CONSOLIDATED STATEMENTS OF OPERATIONS
(in thousands, except per share data)

	Year Ended December 31,		
	2009	2010	2011
Revenue:			
Carrier Services	\$357,339	\$391,762	\$447,894
Enterprise Services	109,914	129,104	151,390
Information Services	—	—	21,171
Total revenue	467,253	520,866	620,455
Operating expense:			
Cost of revenue (excluding depreciation and amortization shown separately below)	99,436	111,282	137,992
Sales and marketing	80,676	86,363	109,855
Research and development	14,094	13,780	17,509
General and administrative	52,491	65,496	96,317
Depreciation and amortization	29,852	32,861	46,209
Restructuring charges	974	5,361	3,549
	277,523	315,143	411,431
Income from operations	189,730	205,723	209,024
Other (expense) income:			
Interest and other expense	(5,213)	(6,995)	(6,279)
Interest and other income	7,491	7,582	1,966
Income from continuing operations before income taxes	192,008	206,310	204,711
Provision for income taxes, continuing operations	76,498	82,282	81,137
Income from continuing operations	115,510	124,028	123,574
(Loss) income from discontinued operations, net of tax	(14,369)	(17,819)	37,249
Net income	\$101,141	\$106,209	\$160,823
Basic net income (loss) per common share:			
Continuing operations	\$ 1.55	\$ 1.66	\$ 1.69
Discontinued operations	(0.19)	(0.24)	0.51
Basic net income per common share	\$ 1.36	\$ 1.42	\$ 2.20
Diluted net income (loss) per common share:			
Continuing operations	\$ 1.53	\$ 1.63	\$ 1.66
Discontinued operations	(0.19)	(0.23)	0.50
Diluted net income per common share	\$ 1.34	\$ 1.40	\$ 2.16
Weighted average common shares outstanding:			
Basic	74,301	74,555	72,974
Diluted	75,465	76,065	74,496

See accompanying notes.

NEUSTAR, INC.

CONSOLIDATED STATEMENT OF STOCKHOLDERS' EQUITY
(in thousands)

	Class A Common Stock		Class B Common Stock		Additional Paid-in Capital	Treasury Stock	Accumulated Other Comprehensive Loss	Retained Earnings	Total Stockholders' Equity
	Shares	Amount	Shares	Amount					
Balance at December 31, 2008	78,925	\$ 79	4	\$—	\$321,528	\$(128,403)	\$(879)	\$194,328	\$ 386,653
Common stock options exercised	344	—	—	—	1,706	—	—	—	1,706
Stock-based compensation expense	—	—	—	—	14,279	—	—	—	14,279
Conversion of Class B common stock to Class A common stock	1	—	(1)	—	—	—	—	—	—
Restricted stock granted, net	155	—	—	—	—	—	—	—	—
Common stock received for tax withholding	—	—	—	—	—	(354)	—	—	(354)
Excess tax benefit from stock option exercises	—	—	—	—	596	—	—	—	596
Net income	—	—	—	—	—	—	—	101,141	101,141
Other comprehensive income									
Unrealized gain on investments, net of tax of \$170	—	—	—	—	—	—	141	—	141
Foreign currency translation adjustment, net of tax of \$114	—	—	—	—	—	—	275	—	275
Comprehensive income	—	—	—	—	—	—	—	—	101,557
Balance at December 31, 2009	79,425	79	3	—	338,109	(128,757)	(463)	295,469	504,437
Common stock options exercised	596	1	—	—	7,765	—	—	—	7,766
Stock-based compensation expense	—	—	—	—	18,252	—	—	—	18,252
Restricted stock granted, net	274	—	—	—	—	—	—	—	—
Common stock repurchase	—	—	—	—	—	(40,400)	—	—	(40,400)
Common stock received for tax withholding	—	—	—	—	—	(691)	—	—	(691)
Net excess tax benefit from stock option exercises	—	—	—	—	220	—	—	—	220
Net income	—	—	—	—	—	—	—	106,209	106,209
Other comprehensive income									
Unrealized gain on investments, net of tax of \$140	—	—	—	—	—	—	277	—	277
Foreign currency translation adjustment, net of tax of \$109	—	—	—	—	—	—	42	—	42
Comprehensive income	—	—	—	—	—	—	—	—	106,528
Balance at December 31, 2010	80,295	80	3	—	364,346	(169,848)	(144)	401,678	596,112
Common stock options exercised	2,340	3	—	—	39,275	—	—	—	39,278
Stock-based compensation expense	—	—	—	—	28,088	—	—	—	28,088
Equity awards assumed in TARGUSinfo acquisition	—	—	—	—	677	—	—	—	677
Restricted stock granted, net	324	—	—	—	—	—	—	—	—
Common stock repurchase	—	—	—	—	—	(324,301)	—	—	(324,301)
Common stock received for tax withholding	—	—	—	—	—	(1,641)	—	—	(1,641)
Net excess tax benefit from stock option exercises	—	—	—	—	4,212	—	—	—	4,212
Net income	—	—	—	—	—	—	—	160,823	160,823
Other comprehensive income									
Unrealized loss on investments, net of tax of \$214	—	—	—	—	—	—	(451)	—	(451)
Foreign currency translation adjustment, net of tax of \$46	—	—	—	—	—	—	(163)	—	(163)
Comprehensive income	—	—	—	—	—	—	—	—	160,209
Balance at December 31, 2011	82,959	\$ 83	3	\$—	\$436,598	\$(495,790)	\$(758)	\$562,501	\$ 502,634

See accompanying notes.

NEUSTAR, INC.
CONSOLIDATED STATEMENTS OF CASH FLOWS
(in thousands)

	Year Ended December 31,		
	2009	2010	2011
Operating activities:			
Net income	\$101,141	\$106,209	\$ 160,823
Adjustments to reconcile net income to net cash provided by operating activities:			
Depreciation and amortization	38,040	40,167	46,837
Stock-based compensation	14,279	18,252	28,088
Amortization of deferred financing costs and original issue discount on debt	169	170	764
Excess tax benefits from stock option exercises	(596)	(1,613)	(4,541)
Deferred income taxes	3,248	(4,430)	15,025
Impairment of long-lived assets	—	8,495	—
Provision for doubtful accounts	3,045	2,600	2,596
Gains on available-for-sale investments and trading securities	(4,078)	(7,007)	(701)
Loss on auction rate securities rights	2,524	6,892	—
Amortization of bond premium	—	12	2,975
Loss on asset sale	—	—	1,933
Changes in operating assets and liabilities, net of acquisitions:			
Accounts receivable	3,621	(17,515)	(3,624)
Unbilled receivables	(2,156)	(4,202)	2,111
Notes receivable	759	(1,590)	(4,944)
Prepaid expenses and other current assets	(1,060)	(640)	(8,329)
Deferred costs	3,204	1,746	(1,974)
Income taxes receivable	5,217	—	(18,795)
Other assets	(383)	(520)	—
Other liabilities	4,242	6,774	(3,180)
Accounts payable and accrued expenses	10,397	(12,615)	12,602
Income taxes payable	2,764	439	(1,590)
Accrued restructuring reserve	114	1,448	(657)
Deferred revenue	(9,147)	1,705	994
Net cash provided by operating activities	175,344	144,777	226,413
Investing activities:			
Purchases of property and equipment	(25,497)	(38,077)	(45,785)
Sales and maturities of investments	15,274	37,725	116,128
Purchases of investments	—	(50,762)	(81,239)
Businesses acquired, net of cash acquired	(350)	(21,658)	(695,547)
Net cash used in investing activities	(10,573)	(72,772)	(706,443)
Financing activities:			
Increase in restricted cash	(16)	(44)	(8,852)
Proceeds from note payable	—	—	591,000
Principal repayments on notes payable	(3,377)	(987)	(1,500)
Principal repayments on capital lease obligations	(9,657)	(12,208)	(7,171)
Debt issuance costs	—	—	(20,418)
Proceeds from exercise of common stock options	1,706	7,766	39,278
Excess tax benefits from stock-based compensation	596	1,613	4,541
Repurchase of restricted stock awards	(354)	(691)	(1,641)
Repurchase of common stock	—	(40,400)	(324,301)
Net cash (used in) provided by financing activities	(11,102)	(44,951)	270,936
Effect of foreign exchange rates on cash and cash equivalents	83	(65)	(239)
Net increase (decrease) in cash and cash equivalents	153,752	26,989	(209,333)
Cash and cash equivalents at beginning of year	150,829	304,581	331,570
Cash and cash equivalents at end of year	\$304,581	\$331,570	\$ 122,237
Supplemental cash flow information:			
Cash paid for interest	\$ 1,413	\$ 1,247	\$ 762
Cash paid for income taxes	\$ 56,996	\$ 72,726	\$ 40,715
Non-cash investing activities:			
Property and equipment acquired under capital leases	\$ 10,787	\$ 1,414	\$ 1,141
Accounts payable incurred to purchase property and equipment	\$ 3,672	\$ 1,104	\$ 2,733
Equity awards assumed in TARGUSinfo acquisition	\$ —	\$ —	\$ 677

See accompanying notes.

NEUSTAR, INC.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

1. DESCRIPTION OF BUSINESS AND ORGANIZATION

NeuStar, Inc. (the Company or Neustar) is a trusted, neutral provider of real-time information and analytics to the Internet, communications, entertainment, advertising and marketing industries throughout the world. Using the Company's advanced, secure technologies, the Company provides addressing, routing, policy management and authentication services that enable its customers to find their end users, route network traffic to the optimal location and verify end-user identity. The Company provides services to both communications service providers, or carriers, and commercial businesses, or enterprises. With the Company's expertise in database management and analysis, the Company also provides cyber security, marketing and advertising information and analytics to its customers.

The Company was incorporated as a Delaware corporation in 1998. The Company was founded to meet the technical and operational challenges of the communications industry when the U.S. government mandated local number portability in 1996. The Company provides the authoritative solution that the communications industry relies upon to meet this mandate. Since then, the Company has grown to offer a broad range of innovative services, including registry services, managed domain name system (DNS) services, Internet Protocol (IP) services, fixed IP geolocation services, Internet security services, caller identification (Caller ID) services, web performance monitoring services, and real-time information and analytics services.

The Company operates in three segments:

- *Carrier Services.* The Company's carrier services include numbering services, order management services and IP services. Through its set of unique databases and system infrastructure in geographically dispersed data centers, the Company manages the increasing complexity in the communications industry and ensures the seamless connection of its carrier customers' numerous networks, while also enhancing the capabilities and performance of their infrastructure. The Company operates the authoritative databases that manage virtually all telephone area codes and numbers, and enables the dynamic routing of calls and text messages among numerous competing carriers in the United States and Canada. All carriers that offer telecommunications services to the public at large in the United States and Canada must access a copy of the Company's unique database to properly route their customers' calls and text messages. The Company also facilitates order management and workflow processing among carriers, and allows operators to manage and optimize the addressing and routing of IP communications.
- *Enterprise Services.* The Company's enterprise services include Internet infrastructure services and registry services. Through the Company's global directory platform, the Company provides a suite of DNS services to its enterprise customers. The Company manages a collection of directories that maintain addresses in order to direct, prioritize and manage Internet traffic, and to find and resolve Internet queries and top-level domains. The Company is the authoritative provider of essential registry services and manages directories of similar resources, or addresses, that its customers use for reliable, fair and secure access and connectivity. In addition, enterprise customers rely on the Company's services to monitor and load-test websites to help identify issues and optimize performance. The Company also provides fixed IP geolocation services that help enterprises identify the location of their online consumers for a variety of purposes, including fraud prevention and marketing. Additionally, the Company provides directory services for the 5- and 6-digit number strings used for all U.S. Common Short Codes, which is part of the short messaging service relied upon by the U.S. wireless industry.
- *Information Services.* The Company's information services include on-demand solutions that help carriers and enterprises identify, verify, score and locate customers and prospective customers. The Company's authoritative databases and solutions enable its clients to make informed decisions in real

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time about consumer-initiated interactions on the Internet, over the telephone and at the point of sale, by correlating consumer identifier information with attributes such as demographics, buying behaviors and location. This allows the Company's customers to offer consumers more relevant services and products, and leads to higher client conversion rates. The Company's business listings identity management services help local businesses and national brands improve the visibility of their online business listings on local search engines. Using the Company's proprietary database, the Company's online display advertising solution allows marketers to display, in real time, advertisements that will be most relevant to online consumers without the need for online behavioral tracking.

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Basis of Presentation and Consolidation

The consolidated financial statements include the accounts of the Company and its wholly owned subsidiaries. All material intercompany transactions and accounts have been eliminated in consolidation. The Company consolidates investments where it has a controlling financial interest. The usual condition for controlling financial interest is ownership of a majority of the voting interest and, therefore, as a general rule, ownership, directly or indirectly, of more than 50% of the outstanding voting shares is a condition indicating consolidation. The Company does not have any variable interest entities or investments accounted for under the equity method of accounting.

Discontinued Operations

A business is classified as discontinued operations when (1) the operations and cash flows of the business can be clearly distinguished and have been or will be eliminated from the Company's ongoing operations; (2) the business has either been disposed of or is classified as held for sale; and (3) the Company will not have any significant continuing involvement in the operations of the business after the disposal transaction. The results of discontinued operations (as well as the gain or loss on the disposal) are aggregated and separately presented in the Company's consolidated statement of operations, net of income taxes.

Acquisition of Targus Information Corporation

On November 8, 2011, the Company completed its acquisition of Targus Information Corporation (TARGUSinfo). Additional details regarding this acquisition are included in Note 3 below.

Reclassification

In the second quarter of 2011, the Company ceased operations of its Converged Messaging Services business, a component previously presented within the Company's Carrier Services operating segment. The results of operations of its Converged Messaging Services business have been reclassified as discontinued operations for all periods presented (see Note 3).

Use of Estimates

The preparation of financial statements in conformity with U.S. generally accepted accounting principles (U.S. GAAP) requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities, the disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenue and expense during the reporting periods. Significant estimates and assumptions are inherent in the analysis and the measurement of deferred tax assets; the identification and quantification of

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income tax liabilities due to uncertain tax positions; restructuring liabilities; valuation of investments; recoverability of intangible assets, other long-lived assets and goodwill; and the determination of the allowance for doubtful accounts. The Company bases its estimates on historical experience and assumptions that it believes are reasonable. Actual results could differ from those estimates.

Fair Value of Financial Instruments

The Financial Accounting Standards Board (FASB) Accounting Standards Codification (ASC) Topic Financial Instruments requires disclosures of fair value information about financial instruments, whether or not recognized in the balance sheet, for which it is practicable to estimate that value. The carrying amounts reported in the accompanying consolidated financial statements approximate the fair value for cash and cash equivalents, accounts receivable, accounts payable and accrued expenses due to their short-term nature. The Company determines the fair value of its investments using third-party pricing sources, which primarily use a consensus price or weighted average price for the fair value assessment. The consensus price is determined by using matrix prices from a variety of industry standard pricing services, data providers, large financial institutions and other third party sources and utilizing those matrix prices as inputs into a distribution-curve-based algorithm to determine the estimated market value. Matrix prices are based on quoted prices for securities with similar terms (i.e. coupon rate, maturity, credit rating) (see Note 5). The Company believes the carrying value of its notes receivable approximates fair value as the interest rate approximates a market rate. The Company believes the carrying value of its long-term debt approximates the fair value of the debt as the terms and rates approximate market rates.

The estimated fair values of the Company's financial instruments are as follows (in thousands):

	December 31,			
	2010		2011	
	Carrying Amount	Fair Value	Carrying Amount	Fair Value
Cash and cash equivalents	\$331,570	\$331,570	\$122,237	\$122,237
Restricted cash (current assets)	\$ 556	\$ 556	\$ 10,251	\$ 10,251
Short-term investments	\$ 13,802	\$ 13,802	\$ 10,545	\$ 10,545
Notes receivable (including current portion)	\$ 1,590	\$ 1,590	\$ 6,534	\$ 6,534
Marketable securities (other assets, long-term)	\$ 3,681	\$ 3,681	\$ 4,008	\$ 4,008
Long-term investments	\$ 37,009	\$ 37,009	\$ 2,506	\$ 2,506
Deferred compensation (other liabilities long-term)	\$ 3,621	\$ 3,621	\$ 4,028	\$ 4,028
Note payable (including current portion)	\$ —	\$ —	\$589,665	\$589,665

Cash and Cash Equivalents

The Company considers all highly liquid investments, which are investments that are readily convertible into cash and have original maturities of three months or less at the time of purchase, to be cash equivalents.

Restricted Cash

As of December 31, 2010 and 2011, restricted cash was \$0.6 million and \$10.3 million, respectively. As of December 31, 2011, cash of \$9.2 million was restricted as collateral for the Company's outstanding letters of credit (see Note 9). As of December 31, 2010 and December 31, 2011, cash of \$0.6 million and \$1.1 million, respectively, was restricted for deposits on leased facilities.

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Concentrations of Credit Risk

Financial instruments that are potentially subject to a concentration of credit risk consist principally of cash, cash equivalents, investments, and accounts receivable. The Company's cash management and investment policies are in place to restrict placement of these instruments with only financial institutions evaluated as highly creditworthy.

With respect to accounts receivable, the Company performs ongoing evaluations of its customers, generally granting uncollateralized credit terms to its customers, and maintains an allowance for doubtful accounts based on historical experience and management's expectations of future losses. Customers under the Company's contracts with North American Portability Management LLC (NAPM) are charged a Revenue Recovery Collection (RRC) fee (see "Accounts Receivable, Revenue Recovery Collection and Allowance for Doubtful Accounts" below).

Investments

The Company's investments classified as available-for-sale are carried at estimated fair value with unrealized gains and losses reported as a separate component of accumulated other comprehensive loss. Realized gains and losses and declines in value judged to be other-than-temporary, if any, on available-for-sale securities are included in other (expense) income. The cost at time of sale of available-for-sale investments is based upon the specific identification method. Interest and dividends on these securities is included in interest and other income.

The Company periodically evaluates whether any declines in the fair value of its investments are other-than-temporary. This evaluation consists of a review of several factors, including but not limited to: the length of time and extent that a security has been in an unrealized loss position; the existence of an event that would impair the issuer's future earnings potential; the near-term prospects for recovery of the market value of a security; the Company's intent to sell an impaired security; and the probability that the Company will be required to sell the security before the market value recovers. If an investment which the Company does not intend to sell prior to recovery declines in value below its amortized cost basis and it is not more likely than not that the Company will be required to sell the related security before the recovery of its amortized cost basis, the Company recognizes the difference between the present value of the cash flows expected to be collected and the amortized cost basis, or credit loss, as an other-than-temporary charge in interest and other expense. The difference between the estimated fair value and the security's amortized cost basis at the measurement date related to all other factors is reported as a separate component of accumulated other comprehensive loss.

The Company's investments classified as trading are carried at estimated fair value with unrealized gains and losses reported in other (expense) income. During 2010, the Company classified its auction rate securities as trading pursuant to the Investments — Debt and Equity Securities Topic of the FASB ASC, with changes in the fair value of these securities recorded in earnings (see Note 4 and Note 5). Interest and dividends on these securities are included in interest and other income.

Accounts Receivable, Revenue Recovery Collections and Allowance for Doubtful Accounts

Accounts receivable are recorded at the invoiced amount and do not bear interest. In accordance with the Company's contracts with NAPM, the Company bills a RRC fee to offset uncollectible receivables from any individual customer. The RRC fee is based on a percentage of monthly billings. During 2009, the RRC fee was 0.75%. On July 1, 2010, the RRC fee was reduced to 0.65% and remained at that level through December 31, 2011. The RRC fees are recorded as an accrued liability when collected. If the RRC fee is insufficient, the

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amounts can be recovered from the customers. Any accrued RRC fees in excess of uncollectible receivables are paid back to the customers annually on a pro rata basis. RRC fees of \$2.6 million and \$2.4 million are included in accrued expenses as of December 31, 2010 and 2011, respectively. All other receivables related to services not covered by the RRC fees are evaluated and, if deemed not collectible, are reserved. The Company recorded an allowance for doubtful accounts of \$1.4 million and \$1.9 million as of December 31, 2010 and 2011, respectively. Bad debt expense amounted to \$3.0 million, \$2.6 million and \$2.6 million for the years ended December 31, 2009, 2010 and 2011, respectively.

Deferred Financing Costs

The Company amortizes deferred financing costs using the effective-interest method and records such amortization as interest expense. Amortization of debt discount and annual commitment fees for unused portions of available borrowings are also recorded as interest expense. Direct and incremental costs related to the issuance of debt are capitalized as deferred financing costs and are reported in other assets on the Company's consolidated balance sheets.

Property and Equipment

Property and equipment, including leasehold improvements and assets acquired through capital leases, are recorded at cost, net of accumulated depreciation and amortization. Depreciation and amortization of property and equipment are determined using the straight-line method over the estimated useful lives of the assets, as follows:

Computer hardware	3 – 5 years
Equipment	5 years
Furniture and fixtures	5 – 7 years
Leasehold improvements	Lesser of related lease term or useful life

Amortization expense of assets acquired through capital leases is included in depreciation and amortization expense in the consolidated statements of operations. Replacements and major improvements are capitalized; maintenance and repairs are charged to expense as incurred. Impairments of long-lived assets are determined in accordance with the Property, Plant and Equipment Topic of the FASB ASC. In the fourth quarter of 2010, the Company recorded an impairment charge of \$7.9 million related to property and equipment, including capitalized technology, used by its Converged Messaging asset group (see "Impairment of Long-Lived Assets" below).

The Company capitalizes software development and acquisition costs in accordance with the Intangibles — Goodwill and Other, Internal-Use Software Topic of the FASB ASC, which requires the capitalization of costs incurred in connection with developing or obtaining software for internal use. Costs incurred to develop the application are capitalized, while costs incurred for planning the project and for post-implementation training and maintenance are expensed as incurred. The capitalized costs of purchased technology and software development are amortized using the straight-line method over the estimated useful life of three to five years. During the years ended December 31, 2010 and 2011, the Company capitalized costs related to internal use software of \$28.8 million and \$28.6 million, respectively. Amortization expense related to internal use software for the years ended December 31, 2009, 2010 and 2011 was \$12.4 million, \$15.2 million and \$17.3 million, respectively, and is included in depreciation and amortization expense in the consolidated statements of operations.

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Goodwill

Goodwill represents the excess of the purchase price over the fair value of assets acquired, as well as other identifiable intangible assets. In accordance with the Intangibles — Goodwill and Other Topic of the FASB ASC, goodwill and indefinite-lived intangible assets are not amortized, but are reviewed for impairment at least annually and upon the occurrence of events or changes in circumstances that would reduce the fair value of such assets below their carrying amount. For purposes of the Company's annual impairment test completed on October 1, 2009, the Company identified and assigned goodwill to two reporting units, Clearinghouse and Next Generation Messaging (NGM). For purposes of the Company's annual impairment test completed on October 1, 2010, the Company identified and assigned goodwill to three reporting units, Carrier Services, Internet Infrastructure Services and Registry Services. For purposes of the Company's annual impairment test completed on October 1, 2011, the Company identified and assigned goodwill to two reporting units, Carrier Services and Enterprise Services. The Company's third reporting unit, Information Services, was established as a result of the acquisition of TARGUSinfo on November 8, 2011, and was not included in the Company's annual impairment test completed on October 1, 2011.

Goodwill is tested for impairment at the reporting unit level using a two-step approach. The first step is to compare the fair value of a reporting unit's net assets, including assigned goodwill, to the book value of its net assets, including assigned goodwill. Fair value of the reporting unit is determined using both an income and a market approach. To assist in the process of determining if a goodwill impairment exists, the Company performs internal valuation analyses and considers other market information that is publicly available, and the Company may obtain valuations from external advisors. If the fair value of the reporting unit is greater than its net book value, the assigned goodwill is not considered impaired. If the fair value is less than the reporting unit's net book value, the Company performs a second step to measure the amount of the impairment, if any. The second step is to compare the book value of the reporting unit's assigned goodwill to the implied fair value of the reporting unit's goodwill, using a theoretical purchase price allocation. If the carrying value of goodwill exceeds the implied fair value, an impairment has occurred and the Company is required to record a write-down of the carrying value and charge the impairment as an operating expense in the period the determination is made. There were no goodwill impairment charges recognized during the years ended December 31, 2009, 2010 and 2011.

Segment Reporting

Operating segments are components of an enterprise about which discrete financial information is available that is evaluated regularly by the chief operating decision maker (CODM) in deciding how to allocate resources and in assessing performance. As of December 31, 2011, the Company's CODM evaluates performance and allocates resources based on multiple factors, including segment contribution for the following service categories: Carrier Services, Enterprise Services and Information Services. The Company's operating segments are the same as its reportable segments.

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Identifiable Intangible Assets

Identifiable intangible assets are amortized over their respective estimated useful lives using a method of amortization that reflects the pattern in which the economic benefits of the intangible assets are consumed or otherwise used and are periodically reviewed for impairment. There were no impairment charges recognized during the years ended December 31, 2009 and 2011. In the fourth quarter of 2010, the Company recorded an intangible asset impairment charge of \$0.6 million related to its Converged Messaging asset group (see "Impairment of Long-Lived Assets" below).

The Company's identifiable intangible assets are amortized as follows:

	<u>Years</u>	<u>Method</u>
Acquired technologies	3 – 5	Straight-line
Customer lists and relationships	3 – 10	Various
Trade names and trademarks	3	Straight-line

Amortization expense related to identifiable intangible assets is included in depreciation and amortization expense in the consolidated statements of operations.

Impairment of Long-Lived Assets

In accordance with Property, Plant and Equipment Topic of the FASB ASC, the Company reviews long-lived assets and certain identifiable intangible assets for impairment whenever events or changes in circumstances indicate the carrying amount of an asset may not be recoverable. The Company measures recoverability of assets to be held and used by comparing the carrying amount of the assets to future undiscounted net cash flows expected to be generated by the assets. Recoverability measurement and estimating undiscounted cash flows is performed at the lowest possible level for which there are identifiable cash flows. If the carrying amount of the assets exceeds the future undiscounted cash flows expected to be generated by those assets, such assets fail the recoverability test and an impairment charge would be recognized, measured as the amount by which the carrying amount of the assets exceeds the fair value. Assets to be disposed of are recorded at the lower of the carrying amount or fair value less costs to sell.

In the first quarter of 2010, the Company realigned its organizational structure, and its NGM business was included with other IP-related services in the Company's Carrier Services operating segment. The services, technology and customer base of the NGM business was renamed Converged Messaging Services while the sales and marketing functions were transitioned to the broader Carrier Services operating segment. In the fourth quarter of 2010, the Company decided to exit the Converged Messaging Services business. The Company believes that its decision to exit this business was an indicator of impairment for long-lived assets in its Converged Messaging Services asset group. As a result, in the fourth quarter of 2010, the Company performed a recoverability test and determined that the future undiscounted cash flows of the asset group was less than the carrying value. The Company recorded an \$8.5 million charge for impairment of long-lived assets, the largest component of which was capitalized technology. In determining fair value, the Company utilized estimates from external advisors and valuation models that involved assumptions about replacement cost, obsolescence factors, future cash flows, discount rates and, as appropriate, review of market comparables. During the second quarter of 2011, the Company ceased operations of its Converged Messaging Services business and all corresponding prior period results of this business presented in the Company's consolidated statements of operations have been reclassified to reflect the operations of the Converged Messaging Services business as discontinued operations (see Note 3).

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Revenue Recognition

The Company provides essential technology and directory services to customers pursuant to various private commercial and government contracts. The Company's revenue recognition policies are in accordance with the Revenue Recognition Topic of the FASB ASC.

Significant Contracts

As part of its carrier services, the Company provides number portability administration center services (NPAC Services), which include wireline and wireless number portability, implementation of the allocation of pooled blocks of telephone numbers and network management services in the United States pursuant to seven contracts with NAPM, an industry group that represents all telecommunications service providers in the United States. The aggregate fees for transactions processed under these contracts are determined by an annual fixed-fee pricing model under which the annual fixed fee (Base Fee) was set at \$340.0 million, \$362.1 million and \$385.6 million in 2009, 2010 and 2011, respectively, and is subject to an annual price escalator of 6.5% in subsequent years. These contracts also provide for fixed credits to customers of \$40.0 million in 2009, \$25.0 million in 2010 and \$5.0 million in 2011, which are applied to reduce the Base Fee for the applicable year. Customers under these contracts may earn additional credits of up to \$15.0 million annually in each of 2009, 2010 and 2011 if the customers reach specific levels of aggregate telephone number inventories and adopt and implement certain IP fields and functionality. In the event that the volume of transactions in a given year is above or below the contractually established volume range for that year, the Base Fee may be adjusted up or down, respectively, with any such adjustment being applied against invoices in the following year. To the extent any available additional credits expire unused at the end of a year, they will be recognized in revenue at that time. The Company determines the fixed and determinable fee under these contracts on an annual basis at the beginning of each year and recognizes this fee in its Carrier Services operating segment on a straight-line basis over twelve months.

For 2009, the Company concluded that the fixed and determinable fee equaled \$285.0 million, which represented the Base Fee of \$340.0 million reduced by the \$40.0 million fixed credit and \$15.0 million of available additional credits. During 2009, the Company's carrier customers adopted and implemented the requisite IP fields and functionality, and as a result earned \$7.5 million of the additional credits for each of 2009, 2010 and 2011. However, the customers did not reach the levels of aggregate telephone number inventories required to earn additional credits and as a result, the Company recognized \$7.5 million of additional revenue in the fourth quarter of 2009.

For 2010, the Company concluded that the fixed and determinable fee equaled \$322.1 million, which represented the Base Fee of \$362.1 million, reduced by the \$25.0 million fixed credit and \$15.0 million of additional credits. For 2011, the Company concluded that the fixed and determinable fee equaled \$365.6 million, which represents the Base Fee of \$385.6 million, reduced by the \$5.0 million fixed credit and \$15.0 million of additional credits. During 2010 and 2011, the Company determined that its carrier customers have earned all of the additional credits of \$15.0 million attributable to the adoption and implementation of the requisite IP fields and functionality and the achievement of specific levels of aggregate telephone number inventories.

The total amount of revenue derived under the Company's contracts with NAPM, comprised of NPAC Services, connection service fees related to the Company's NPAC Services and system enhancements, was approximately \$306.1 million, \$337.1 million, and \$374.4 million for the years ended December 31, 2009, 2010 and 2011, respectively.

Fees under the Company's contracts with NAPM are billed to telecommunications service providers based on their allocable share of the total transaction charges. This allocable share is based on each respective

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telecommunications service provider's share of the aggregate end-user services revenues of all U.S. telecommunications service providers, as determined by the Federal Communications Commission. The Company also bills an RRC fee equal to a percentage of monthly billings to its customers, which is available to the Company if any customer under the contracts to provide NPAC services fails to pay its allocable share of total transactions charges.

Carrier Services

Under its seven contracts with NAPM, the Company provides NPAC Services. As discussed above under the heading "Revenue Recognition — Significant Contracts," the Company determines the fixed and determinable fee on an annual basis and recognizes such fee on a straight-line basis over twelve months.

The Company provides NPAC Services in Canada under its long-term contract with the Canadian LNP Consortium Inc. The Company recognizes revenue on a per-transaction fee basis as the services are performed.

The Company generates revenue from its telephone number administration services under two government contracts: North American Numbering Plan Administrator (NANPA) and National Pooling Administrator (NPA). Under its NANPA contract, the Company earns a fixed annual fee and recognizes this fee as revenue on a straight-line basis as services are provided. Under its NPA contract, the Company earns a fixed fee associated with administration of the pooling system. The Company recognizes revenue for this contract on a straight-line basis over the term of the contract. In the event the Company estimates losses on these fixed price contracts, the Company recognizes these losses in the period in which a loss becomes apparent.

The Company generates revenue from connection fees and system enhancements provided under its contracts with NAPM. The Company recognizes connection fee revenue as the service is performed. System enhancements are provided under contracts in which the Company is reimbursed for costs incurred plus a fixed fee, and revenue is recognized based on costs incurred plus a pro rata amount of the fee.

The Company provides hosted Order Management Services, consisting of customer set-up and implementation followed by transaction processing, under contracts with terms ranging from one to three years. Customer set-up and implementation is not considered a separate deliverable; accordingly, the fees for these services are deferred and recognized as revenue on a straight-line basis over the term of the contract. Per-transaction fees are recognized as the transactions are processed.

The Company generates revenue from its licensed Order Management Services under contracts with terms ranging from three months to two years. The Company generates revenue under these contracts for software licenses, implementation and customization services and post-contract support services (PCS). Under these contracts, revenue is recognized when persuasive evidence of an arrangement exists, delivery has occurred, the fee is fixed or determinable, collectability is probable and, if applicable, when vendor-specific objective evidence (VSOE) of fair value exists to allocate the arrangement fee to the undelivered elements of a multiple element arrangement. Revenue is allocated to delivered elements of an arrangement using the residual method. Under the residual method, revenue is allocated to the undelivered elements using VSOE of fair value with the remaining contract fee allocated to the delivered elements and recognized as revenue when all other revenue recognition criteria have been met. For software contracts that include customization services that are essential to the functionality of the delivered software, the software license and implementation and customization revenue is recognized under the contract method of accounting using the percentage-of-completion method. The Company estimates the percentage-of-completion for each contract based on the ratio of direct labor hours incurred to total estimated direct labor hours required under such contract and recognizes an amount of revenue equal to the percentage-of-completion multiplied by the contract amount allocated to the software license and implementation

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and customization services fees. The contract amount allocated to these delivered elements is determined under the residual method approach. The Company determined the VSOE of PCS under the bell-shape curve approach and determined that a substantial majority of its actual PCS renewals are within a narrow range of the median pricing. For arrangements with bundled PCS where there is no stated contractual PCS rate or where the rate is less than the established range of VSOE, the Company utilizes the low end of the range for VSOE as the fair value of PCS. PCS revenue is recognized on a straight-line basis over the service term of the contract.

Enterprise Services

The Company generates revenue from the management of internal and external DNS services. The Company's revenue from these services consists of customer set-up fees, monthly recurring fees and per-transaction fees for transactions in excess of pre-established monthly minimums under contracts with terms ranging from one to three years. Customer set-up fees are not considered a separate deliverable and are deferred and recognized on a straight-line basis over the term of the contract. Under the Company's contracts to provide DNS services, customers have contractually established monthly transaction volumes for which they are charged a recurring monthly fee. Transactions processed in excess of the pre-established monthly volume are billed at a contractual per-transaction rate. Each month, the Company recognizes the recurring monthly fee and usage in excess of the established monthly volume on a per-transaction basis as services are provided.

The Company generates revenue related to its Internet domain name registry services under contracts with terms generally between one and ten years. The Company recognizes revenue on a straight-line basis over the term of the related customer contracts.

The Company generates revenue from its U.S. Common Short Code services under short-term contracts ranging from three to twelve months, and the Company recognizes revenue on a straight-line basis over the term of the related customer contracts.

Information Services

The Company generates revenue from a broad portfolio of real-time information and analytics services. The Company recognizes revenue when persuasive evidence of an agreement exists, the terms are fixed or determinable, services are performed, and collection is reasonably assured. The Company's contracts provide for a guaranteed monthly minimum fee supplemented by fees for transactions above specified minimum amounts. The minimum fee is recognized monthly, and the transaction fees in excess of the monthly minimums are recognized as the services are performed. The Company also receives annual technology fees from certain customers in exchange for access to intellectual property, standard technical support, emergency 24-hour support, and system upgrades on a when-and-if-available basis. Services are not considered a separate deliverable. As a result, technology fees are deferred and recognized on a straight-line basis over the service period, which is usually twelve months.

Revenue derived from the online delivery of data for direct marketing purposes is recorded upon delivery of such data to the customer. Revenue associated with engagements requiring periodic updates of data over the course of the service period, where cash is received or collectible in advance, are recorded as deferred revenues, and recognized on a straight-line basis over the service period, which is usually twelve months.

Accounting for Multiple Element Arrangements Entered Into or Materially Modified After January 1, 2011

In September 2009, the FASB ratified Accounting Standard Update (ASU) 2009-13, Revenue Recognition Topic 605 - Multiple-Deliverable Revenue Arrangements (ASU 2009-13). Under this guidance, when vendor-

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specific objective evidence or third party evidence for deliverables in a multiple-element arrangement cannot be determined, the Company is required to develop a best estimate of the selling price for separate deliverables and allocate arrangement consideration using the relative selling price method. The Company adopted ASU 2009-13 on a prospective basis for arrangements entered into or materially modified on or after January 1, 2011.

During 2009, 2010 and 2011, certain of the Company's arrangements included customer set-up, implementation and technology support services, combined with ongoing transaction processing. These customer set-up, implementation and technology support services were not considered a separate deliverable that provides stand-alone value to the customer and such fees were deferred and recognized as revenue on a straight-line basis over the term of the contract. Accordingly, the adoption of ASU 2009-13 did not have a material effect on the Company's revenue recognized in 2011. Assuming the Company's adoption of ASU 2009-13 on a prospective basis for arrangements entered into or materially modified on or after January 1, 2009, revenue recognized by the Company for the years ended December 31, 2009 and 2010 would not have been materially different.

Service Level Standards

Some of the Company's private commercial contracts require the Company to meet service level standards and impose corresponding penalties on the Company if the Company fails to meet those standards. The Company records a provision for these performance-related penalties in the period in which it becomes aware that it has failed to meet required service levels, triggering the requirement to pay a penalty, which results in a corresponding reduction to revenue.

Cost of Revenue and Deferred Costs

Cost of revenue includes all direct materials costs, direct labor costs, and indirect costs related to the generation of revenue such as indirect labor, outsourced services, materials and supplies, payment processing fees, and general facilities cost. The Company's primary cost of revenue is personnel costs associated with service implementation, product maintenance, customer deployment and customer care, including salaries, stock-based compensation and other personnel-related expense. In addition, cost of revenue includes costs relating to developing modifications and enhancements of the Company's existing technology and services, as well as royalties paid related to U.S. Common Short Code services and registry gateway services. Cost of revenue also includes costs relating to the Company's information technology and systems department, including network costs, data center maintenance, database management, data processing costs and general facilities costs.

Deferred costs represent direct labor related to professional services incurred for the setup and implementation of contracts. These costs are recognized in cost of revenue on a straight-line basis over the contract term. Deferred costs also include royalties paid related to the Company's U.S. Common Short Code services, which are recognized in cost of revenue on a straight-line basis over the contract term. Deferred costs are classified as such on the consolidated balance sheets.

Research and Development

The Company expenses its research and development costs as they are incurred. Research and development expense consists primarily of personnel costs, including salaries, stock-based compensation and other personnel-related expense, consulting fees, and the costs of facilities, computer and support services used in service and technology development.

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Advertising

The Company expenses advertising costs as they are incurred. Advertising expense was approximately \$5.3 million, \$6.7 million and \$6.6 million for the years ended December 31, 2009, 2010 and 2011, respectively.

Stock-Based Compensation

The Company accounts for its stock-based compensation plans under the recognition and measurement provisions of the Compensation — Stock Compensation Topic of the FASB ASC. The Company estimates the value of stock-based awards on the date of grant using the Black-Scholes option-pricing model. For stock-based awards subject to graded vesting, the Company has utilized the “straight-line” method for allocating compensation cost by period.

The Company presents benefits of tax deductions in excess of the compensation cost recognized (excess tax benefits) as a financing cash inflow with a corresponding operating cash outflow. For the years ended December 31, 2009, 2010 and 2011, the Company included \$0.6 million, \$1.6 million and \$4.5 million, respectively, of excess tax benefits as a financing cash inflow with a corresponding operating cash outflow.

Basic and Diluted Net Income per Common Share

In accordance with the Earnings Per Share Topic of the FASB ASC, unvested share-based payment awards that contain non-forfeitable rights to dividends or dividend equivalents (whether paid or unpaid) are participating securities that should be included in the computation of earnings per share under the two-class method. The Company's restricted stock awards are considered to be participating securities because they contain non-forfeitable rights to cash dividends, if declared and paid. In lieu of presenting earnings per share pursuant to the two-class method, the Company has included shares of unvested restricted stock awards in the computation of basic net income per common share as the resulting earnings per share would be the same under both methods.

Basic net income per common share is computed by dividing net income by the weighted-average number of common shares and participating securities outstanding during the period. Unvested restricted stock units and performance vested restricted stock units (PVRSU) are excluded from the computation of basic net income per common share because the underlying shares have not yet been earned by the stockholder and are not participating securities. Shares underlying stock options are also excluded because they are not considered outstanding shares. Diluted net income per common share assumes dilution and is computed based on the weighted-average number of common shares outstanding after consideration of the dilutive effect of stock options, unvested restricted stock units and PVRSU. The effect of dilutive securities is computed using the treasury stock method and average market prices during the period. Dilutive securities with performance conditions are excluded from the computation until the performance conditions are met.

Income Taxes

The Company accounts for income taxes in accordance with the Income Taxes Topic of the FASB ASC. Deferred tax assets and liabilities are determined based on temporary differences between the financial reporting bases and the tax bases of assets and liabilities. Deferred tax assets are also recognized for tax net operating loss carryforwards. These deferred tax assets and liabilities are measured using the enacted tax rates and laws that will be in effect when such amounts are expected to be reversed or utilized. Valuation allowances are provided to reduce such deferred tax assets to amounts more likely than not to be ultimately realized.

The income tax provision includes U.S. federal, state, local and foreign income taxes and is based on pre-tax income or loss. In determining the annual effective income tax rate, the Company analyzes various factors,

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including the Company's annual earnings and taxing jurisdictions in which the earnings will be generated, the impact of state and local income taxes and the ability of the Company to use tax credits and net operating loss carryforwards.

The Company assesses uncertain tax positions in accordance with income tax accounting standards. Under these standards, income tax benefits should be recognized when, based on the technical merits of a tax position, the Company believes that if a dispute arose with the taxing authority and were taken to a court of last resort, it is more likely than not (*i.e.*, a probability of greater than 50 percent) that the tax position would be sustained as filed. If a position is determined to be more likely than not of being sustained, the reporting enterprise should recognize the largest amount of tax benefit that is greater than 50 percent likely of being realized upon ultimate settlement with the taxing authority. The Company's practice is to recognize interest and penalties related to income tax matters in income tax expense.

Foreign Currency

Assets and liabilities of consolidated foreign subsidiaries, whose functional currency is the local currency, are translated to U.S. dollars at fiscal year-end exchange rates. Revenue and expense items are translated to U.S. dollars at the average rates of exchange prevailing during the fiscal year. The adjustment resulting from translating the financial statements of such foreign subsidiaries to U.S. dollars is reflected as a foreign currency translation adjustment and reported as a component of accumulated other comprehensive loss in the consolidated statements of stockholders' equity.

Transactions denominated in currencies other than the functional currency are recorded based on exchange rates at the time such transactions arise. Subsequent changes in exchange rates result in transaction gains or losses, which are reflected within interest and other expense in the consolidated statements of operations.

Comprehensive Income

Comprehensive income is comprised of net earnings and other comprehensive income (loss), which includes certain changes in equity that are excluded from income. The Company includes unrealized holding gains and losses on available-for-sale securities, if any, and foreign currency translation adjustments in other comprehensive income (loss) in the consolidated statements of stockholders' equity. Comprehensive income was approximately \$101.6 million, \$106.5 million and \$160.2 million for the years ended December 31, 2009, 2010 and 2011, respectively.

Recent Accounting Pronouncements

In June 2011, the FASB issued Auditing Standards Update (ASU) 2011-05 (ASU 2011-05), Presentation of Comprehensive Income, to improve the comparability, consistency, and transparency of financial reporting and increase the prominence of items reported in other comprehensive income (OCI). The amendments to this standard require that all non-owner changes in stockholders' equity be presented either in a single continuous statement of comprehensive income or in two separate but consecutive statements. Under either method, adjustments must be displayed for items that are reclassified from OCI to net income, in both net income and OCI. The standard does not change the current option for presenting components of OCI gross or net of the effect of income taxes, provided that such tax effects are presented in the statement in which OCI is presented or disclosed in the notes to the financial statements. Additionally, the standard does not affect the calculation or reporting of earnings per share. In December 2011, the FASB issued ASU 2011-12, Comprehensive Income (Topic 220) — Deferral of the Effective Date for Amendments to the Presentation of Reclassifications of Items Out of Accumulated Other Comprehensive Income in ASU 2011-05 (ASU 2011-12), which defers the effective

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date of only those changes in ASU 2011-05 that relate to the presentation of reclassification adjustments. For public entities, the amendments are effective for fiscal years, and interim periods within those years, beginning after December 15, 2011 and are to be applied retrospectively, with early adoption permitted. The Company does expect the adoption of this standard to have a material impact on its consolidated financial statements.

In September 2011, the FASB issued ASU 2011-08, Testing Goodwill for Impairment, to simplify how entities test goodwill for impairment. The amendments in the update permit an entity to first assess qualitative factors to determine whether it is more likely than not (that is, a likelihood of more than 50 percent) that the fair value of a reporting unit is less than its carrying amount. If this is the case, companies need to perform a more detailed two-step goodwill impairment test which is used to identify potential goodwill impairments and to measure the amount of goodwill impairment losses to be recognized, if any. The amendments are effective for annual and interim goodwill impairment tests performed for fiscal years beginning after December 15, 2011, with early adoption permitted. The Company adopted this update for its annual goodwill impairment test performed as of October 1, 2011. The adoption of this standard did not have a material impact on the Company's consolidated results of operations.

3. ACQUISITIONS AND DISCONTINUED OPERATIONS

The application of the acquisition method of accounting for business combinations requires management to make significant estimates and assumptions in the determination of the fair value of the assets acquired and liabilities assumed in order to properly allocate purchase price consideration. These assumptions and estimates include a market participant's expected use of the asset and the appropriate discount rates from a market participant perspective. The Company's estimates are based on historical experience and information obtained from the management of the acquired company and are determined with assistance from an independent third-party appraisal firm. The Company's significant assumptions and estimates include the cash flows that an acquired asset is expected to generate in the future, the weighted-average cost of capital, long-term projected revenue and growth rates, and the estimated royalty rate in the application of the relief from royalty method.

BrowserMob LLC Acquisition

On July 7, 2010, the Company acquired BrowserMob LLC (BrowserMob) for cash consideration of \$2.2 million. The acquisition of BrowserMob, a provider of on-demand load testing and website monitoring services, expanded the Company's Internet Infrastructure Services. The acquisition was accounted for under the acquisition method of accounting in accordance with the Business Combinations Topic of the FASB ASC and the results of operations of BrowserMob have been included within the Enterprise Services segment in the Company's consolidated statement of operations since the date of acquisition. Of the total purchase price, the Company recorded \$1.1 million of goodwill and \$1.0 million of definite-lived intangible assets. Definite-lived intangible assets consist of customer relationships and acquired technology. The Company is amortizing customer relationships and acquired technology on a straight-line basis over an estimated useful life of 3 years and 5 years, respectively.

Quova, Inc. Acquisition

On October 27, 2010, the Company acquired Quova, Inc. (Quova) for cash consideration of \$21.7 million, which price was subject to certain purchase price adjustments. Quova expanded the Company's Internet Infrastructure Services by providing internet geography data services that enable online businesses to detect and prevent fraud, ensure regulatory compliance, manage digital content rights distribution and localize ads and web content. The acquisition was accounted for under the acquisition method of accounting in accordance with the Business Combinations Topic of the FASB ASC and the results of operations of Quova have been included